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ABSTRACT

The State and Local Fiscal Assistance Act of 1972 was shaped by a decade of discussion and compromise. Under the Act, federal funds have been disbursed to all State and local general purpose governments from 1972 through 1976. This legislation has been renewed without major revision. The principal focus of this work is an evaluation of the program's allocation of funds to cities. The actual allocation of general revenue sharing funds to cities is tested by means of multiple regression analysis against four criteria commonly offered as guidelines for disbursing intergovernmental grants. Results from regressions run on data for 39 California and 30 Michigan cities indicate that the four normative factors are not well reflected in the distribution of shared revenue under the 1972 Act. The redistributive impact of the program on poor citizens, as distinguished from poor jurisdictions, is also examined. This impact was found to be negligible. Finally, an illustrative program designed to promote redistribution is outlined and its impact is contrasted with that of the existing program. (Author/GC)

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GENERAL REVENUE SHARING AND REDISTRIBUTION

William B. Neenan

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GENERAL REVENUE SHARING AND REDISTRIBUTION

By WILLIAM B. NEENAN*
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The State and Local Fiscal Assistance Act of 1972 was shaped by a decade of discussion and compromise. Under the Act, $30.2 billion of federal funds have been disbursed to all state and local general purpose governments during the five years, 1972-76. In 1972 this meant that in addition to the governments of the 50 states and the District of Columbia, 38,552 local governments were eligible to receive the $5.3 billion of shared revenue funds to be allocated in that year. Of these governments 3,044 were counties, 18,517 municipalities, and 16,991 townships. The 15,781 independent school districts and 23,885 special purpose districts, not being general purpose local governments, were not eligible to receive funds. [Nathan, Manvel and Calkins, pp. 31, 41] Since this legislation has recently been renewed without major revision an evaluation of its effectiveness is appropriate.

The principal focus of this article will be an evaluation of this program's allocation of funds to cities. First, the actual allocation of general revenue sharing funds to cities will be tested by means of multiple regression analysis against four criteria commonly offered as guidelines for disbursing intergovernmental grants. Second, the redistributive impact of the program on poor *citizens* as distinguished from poor *jurisdictions* will be examined. Finally, an illustrative program designed to promote redistribution will be outlined and its impact contrasted with that of the existing program.

I. NORMATIVE CRITERIA

Four normative criteria are proposed here as relevant for evaluating the allocation of intergovernmental grants to cities. 1) A city with a

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disproportionately large poverty population is twice handicapped: it must provide poverty-related programs and it has a relatively smaller proportion of higher-income tax payers. Hence, the poverty population of a city constitutes an index of one title to intergovernmental funds. 2) To the extent commuters and other nonresidents impose net costs on a city that are not compensated for through such devices as a nonresident income tax or a local sales tax, intergovernmental grants can serve as a mechanism for providing such compensation. 3) The cost of maintaining a given level of city services, for example, police and fire protection, may be higher per capita in a densely populated city with an older private and public capital infrastructure than in a newly developed city. Intergovernmental grants are a way in which differential fiscal residuals resulting from these cost differentials can be equalized for citizens in the two cities. 4) On the other hand, to the extent a city can export taxes to residents of other jurisdictions, for example, by shifting business property taxes, a city in effect receives external assistance thereby reducing its claim to intergovernmental aid. [See Neenan, Chapter 6, and Bowman.]

In order to test whether these four normative factors are reflected in the distribution of shared revenue under the 1972 Act, regressions have been run on data for 39 California and 30 Michigan cities. For each state sample the 1976 per capita entitlements are regressed on four variables selected as proxies for the normative considerations just discussed: 1) percent of the city's 1970 population that is poor (POOR); 2) the ratio in 1970 of employment in the city to the city's population (EMP); 3) the percentage of the city's housing stock built before 1950 (OLD); and 4) percent of the city's taxable property (in 1968 for Michigan and 1972 for California) that is commercial and industrial (CIP). The pattern of entitlements across these cities will meet normative requirements for intergovernmental aid if 1) the coefficients on POOR, EMP, and OLD are positive, indicating that the entitlements are higher the larger are a city's poverty population, the number of workers who commute into the city, and the relative age of its housing stock; and 2) the coefficient on CIP is negative, indicating that entitlements are smaller to the extent a community has a large commercial and industrial taxable base which permits tax-exporting.

From the regression results shown in Column I of Tables 1 and 2 we see that the normative expectations do not fare well. For both California and Michigan the coefficients for EMP are negative, indi-

cating that the larger a jurisdiction's commuting population relative to its resident population, the smaller its per capita entitlement, even though only in California is this relationship statistically significant. The results for OLD are mixed. In Michigan indeed the older the housing stock, the larger the per capita entitlements, as is normatively suggested. In California, on the other hand, the relationship is negative, though not statistically significant. Only for POOR do the results from both states meet the normative prescription. For both California and Michigan the per capita entitlements are positively associated with the percentage of a jurisdiction's population that is poor. Finally, and perhaps of greatest moment for policy considerations, the coefficients on CIP in both the California and Michigan regressions are positive and highly significant. Thus those communities with the larger commercial and industrial tax base and so presumably the greater ability to export a greater part of their tax burden are precisely those communities that receive the larger per capita general revenue sharing entitlements.

Results are shown in Column II of Tables 1 and 2 of regressing per capita entitlements for the California and Michigan cities on the cities' per capita income (PCI) and per capita tax collections (PCT). Since these two variables are factors actually employed in the various steps of the within-state allocation process, although in a different functional form than in the regressions, they are significant predictors of the variation in per capita entitlements across the cities. However, POOR would seem to be a more direct index of the financial burden imposed on a city by its dependent population than PCI. If the alleviation of this burden is indeed a goal of the shared revenue program, it would seem to be more appropriate to use POOR in the allocation formula rather than PCI, which is a more or less close proxy. That such a substitution would have a notable impact on the distribution of shared revenue can be seen by comparing the regressions results shown in Columns II and III of Tables 1 and 2. If POOR replaces PCI and PCT retained in the regressions, the explained variation in 1976 per capital entitlements (the R^2 value) is reduced for cities in both states. Indeed the impact on the variation in per capita entitlements due to a substitution of POOR for PCI is underestimated if we simply compare the R^2's of the two regressions. Since PCI^2 is the form used in the actual allocation formula, if PCI^2 rather than PCI were used as the independent variable in the regressions, the R^{-2} would fall below 1.0 only to the extent that constraints in the de-

TABLE 1

REGRESSION RESULTS OF PER CAPITA ENTITLEMENTS (1976), SELECTED CALIFORNIA CITIES, ON VARIOUS INDEPENDENT VARIABLES

Variables	I	II	III	IV
Constant	−0.87	+21.1	+0.073	+14.7
	(−0.67)	(+16.65)	(+0.05)	(+6.04)
CIP	+0.24			+0.04
	(+5.38)			(+1.25)
POOR	+0.69		+0.66	+0.30
	(+5.74)		(+6.26)	(+3.32)
EMP	−7.95			+1.03
	(−2.45)			(+0.47)
OLD	−0.03			−0.02
	(−1.29)			(−1.21)
PCI		− 0.0046		−0.004
		(−15.51)		(−7.26)
PCT		+ 0.094	+0.35	+0.07
		(+13.57)	(+2.76)	(+8.41)
R^2 =	0.74	0.90	0.60	0.92

Note: t ratios in parentheses.

Sources of data: Per capita entitlements: U.S. Department of Treasury *6th Entitlements.*

CIP (for California): U.S. Department of Commerce, *Census of Governments,* 1972.

POOR, EMP, OLD: U.S. Department of Commerce, *County and City Data Book 1972.*

PCI and PCT: U.S. Department of Treasury, *Initial Data Elements, Entitlement 6.*

termination of the entitlements, such as the 20 percent and the 145 percent rules, were operative.

Finally, in Column IV of Tables 1 and 2 results are shown of regressing per capita entitlements on all six of the variables used in the previous regressions. PCI and PCT are statistically significant in the regressions for both states. However, the coefficients for CIP remain positive for both states and are statistically significant in the Michigan regression. The coefficients for POOR are also positive in both regressions but only the California coefficient is significant. The fact that the coefficients for CIP remain positive even when controlling for PCT indicates that cities in California and Michigan receive larger entitlements not only as a reward for collecting higher taxes (i.e. PCT), as is intended, but also perversely, to the extent that they have tax bases that permit considerable tax-exporting. Finally, since POOR is positive even when PCI is also used as a predictor

TABLE 2

REGRESSION RESULTS OF PER CAPITA ENTITLEMENTS (1976), SELECTED MICHIGAN CITIES, ON VARIOUS INDEPENDENT VARIABLES

Variables	I	II	III	IV
Constant	− 1.38	+28.62	+27.39	+10.4
	(− 0.64)	(+ 7.24)	(+ 1.34)	(+ 2.39)
CIP	+ 0.26			+ 0.219
	(+ 2.57)			(+ 2.64)
POOR	+ 0.40		+ 0.807	+ 0.215
	(+ 2.67)		(+ 5.50)	(+ 1.62)
EMP	−11.56			−10.3
	(− 0.98)			(− 1.05)
OLD	+ 0.09			+ 0.051
	(+ 2.34)			(+ 1.65)
PCI		− 0.005		− 0.0025
		(− 6.45)		(− 3.40)
PCT		+ 0.079	+ 0.511	+ 0.038
		(+ 5.24)	(+ 2.89)	(+ 2.97)
R^2	0.79	0.72	0.66	0.87

Note: t raitos in parentheses.

Sources of data: Per capital entitlements: U.S. Department of Treasury. *6th Entitlements.*

CIP (for Mich.): Snyder.

POOR, EMP, OLD: U.S. Department of Commerce, *County and City Data Book 1972.*

PCI & PCT: U.S. Department of Treasury, *Initial Data Elements, Entitlement 6.*

variable, we have further evidence that POOR and PCI are to some extent measuring different phenomena and that cities with relatively large poverty populations are not especially favored by general revenue sharing.

II. INCOME SUPPORT FOR POOR CITIZENS

A principal argument offered in support of general revenue sharing is its alleged redistributive impact. The fact that the allocation formulas used at the various stages in the distribution of funds all include income-conditioned variables seems to offer prima facie evidence that the program is indeed redistributive at the *jurisdictional* level. However we will now address the question of whether and, if so, by how much the program can be expected ultimately to increase the disposable income of poor *citizens*.

Conceptually we can envision shared revenue being employed by recipient governments to increase the real disposable income of poor

citizens through two mechanisms: 1) by directly reducing the tax burden of the poor and/or funding programs that favor low income citizens; and 2) by increasing the fiscal attractiveness of a jurisdiction to high income residents thereby increasing its taxable base, and thus ultimately, through a trickle-down process, allowing the fiscal burden of the poor to be eased. This latter alternative seems to describe the strategic approach that Buchanan recommends to cities: "Fiscal decisions must be made strategically rather than reactively. Translated into practical policy terms this means that potentially-mobile central-city taxpayers who contribute to net fiscal surplus must be deliberately induced to remain in the sharing community by appropriate fiscal adjustment." [p. 1]

Buchanan, of course, envisions a broader range of responses than merely a city's use of revenue sharing—just as revenue sharing itself has been defended on grounds other than increasing disposable income for low income citizens. Nonetheless it is legitimate to judge the effectiveness of the program against this criterion. Hence, in this section general revenue sharing will be evaluated in terms of its target effectiveness as a redistributive program in favor of the urban poor. The increase in real income to be expected for the poverty population of one city, St. Louis, resulting both directly and indirectly from the use of its revenue sharing grant will be compared with the increased income the same poverty population would receive from an individual income support program of equal dollar cost.

A. *The Model*

Both the direct and indirect redistributive gain to a city's poverty population resulting from intergovernmental shared revenue can be described in terms of the following simple model.

If (1) $G_i = E_i - T_i$
(2) $T_i = (B_i)\ (R_i)$

where

G_i = real income gain to i^{th} group, i = r (rich) or p (poor)
E_i = expenditures benefiting i^{th} group
T_i = tax burden on i^{th} group
B_i = taxable base of i^{th} group
R_i = tax rate for i^{th} group,

and if it is assumed 1) that the shared revenue (S) received by a city is used to reduce the tax rate on the rich (R_r) and/or increase expenditures that directly favor the rich (E_r) and 2) that this policy, by making the city more attractive to those with high income thus increases the city's taxable base,
then

$$(3)\quad B_r = B_r[R_r(S),\ E_r(S)]$$

where

S = shared revenue

and

$$\frac{dB_r}{dS} = \frac{\delta B_r}{\delta R_r}\frac{dR_r}{dS} > 0 + \frac{\delta B_r}{\delta E_r}\frac{dE_r}{dS} > 0.$$

Finally, the larger taxable base resulting from this policy permits a reduction in the tax rate on the poor in the city (R_p), *ceteris paribus*. In this way it is possible that the disposable income of the poor can be increased by using the shared revenue directly 1) to reduce the tax rate (or increase expenditures) for the poor and/or directly 2) to do the same for the rich with the consequence that the taxable base of the rich is increased thus allowing a reduction in the tax rate and/or increased expenditures for the poor, *ceteris paribus*.
Thus

$$(4)\quad R_p = R_p[S,\ B_r(S)]$$

with

$$\frac{dR_p}{dS} = \frac{dR_p}{dS} < 0 + \frac{\delta R_p}{\delta Br}\frac{dB_r}{dS} < 0.$$

B. *An Illustrative Example*

Two empirical questions can be examined by this simple model: 1) How large is the direct income gain to lower income residents of a city if the total shared revenue entitlement is used to reduce their tax rates, and 2) How much do lower income residents stand to gain indirectly through the retention within the city of higher income residents with their associated larger taxable base? The answers to these question will enable us to judge the redistributive effect on individuals of general revenue sharing. For an illustrative example let us assume that St. Louis receives a grant of $4 million, approximately the additional amount it would receive if $2 billion additional funds

were appropriated for general revenue sharing and distributed according to the distribution algorithms of the 1972 Act.[1]

If it is assumed that this $4 million grant to St. Louis were used exclusively to reduce property tax rates in the city,[2] the effective property tax rate would be reduced from 2.00 to 1.85 percent and the poverty population of the city would enjoy an estimated direct increase in disposable real income of $224,000.[3] Thus, 5.5 percent of the shared revenue would directly benefit the poor in St. Louis. In order to estimate the indirect gain to low-income residents due to the retention of higher income residents with their higher taxable base, we would need to know 1) the elasticity of a high-income residency with respect to property tax rates combined with 2) the elasticity of the taxable base with respect to high-income residency (equation 3). Without values for these relationships we cannot give a precise measure of the indirect gain to low income resident from the shared revenue program.

Some general parameters can be indicated, however, of the likely indirect gain to poor citizens in St. Louis from a general reduction in tax rates. Thus 1) if it is assumed that after revenue sharing the effective property tax rate is 1.78 percent, the taxable property base

[1] See Table 3, Column 3 where it is estimated that St. Louis would receive $4,350,000 additional revenue from such a program.

[2] In 1970 property tax collections were $36.6 million with a taxable base of $1.758 billion. [U.S. Department of Commerce, *County and City Data Book 1972*]

[3] This estimate is derived in the following manner:

a) The average effective tax rate of the St. Louis property tax in 1970 in terms of money income was 2 percent ($36.6 million property tax collections divided by $1.805 billion total money income equals 0.02). [U.S. Department of Commerce, *County and City Data Book 1972*].

b) If the $4 million in shared revenue is used entirely for property tax relief, the average effective rate falls to 1.78 percent ($36.6 million less $4 million equals $32.6 million divided by $1.805 billion equals 0.0178).

c) Pechman and Okner estimate that in 1966 the average effective property tax rate in the United States was 3.0 percent and the rate on income under $5,000 per year was 2.7 percent, under the assumption that the tax is borne by property owners. [Pechman and Okner] Since the average effective property tax rate in 1970 was 2.0 percent in St. Louis, the rate on those with annual income under $5,000 should be 1.8 percent before revenue sharing and 1.6 percent after revenue sharing, if we simply scale down the national distribution of the rates.

d) On this basis, the total property tax liability of those with income under $5,000 would be $2.026 million before revenue sharing and $1.802 million after revenue sharing, or a gain of $224,000. (It is estimated that the total income received in 1969 by those in St. Louis with less than $5,000 income was $112.6 million times .018 equals $2.026 million and times .016 equals $1.802 million.) [U.S. Department of Commerce, *County and City Data Book 1972*]

of St. Louis would have to increase by $114 million, or 6.5 percent of the 1970 taxable base, in order to generate property tax revenue equal to the amount paid by those with less than $5,000 income in 1975. 2) There would have to be an increase in the taxable base of $212 million, or 12.1 percent, to generate sufficient additional property tax revenue ($3,774,000) to provide an indirect increase in the disposable income of the poor so that, when added to their direct gain of $224,000, the total increase in the disposable income of the St. Louis poor from the property tax reduction would equal the $4,000,000 revenue sharing entitlement.[4] Although we do not possess quantitative values for the variables in equation 3, it scarcely seems plausible that a relatively modest decrease in property rates would trigger such sizable increases in the property tax base.[5]

There is of course the related approach of using shared revenue to increase expenditures for selected city functions that are highly desired by the rich. Would such increased expenditures serve to retain the high income residents of a city and so with a larger taxable base permit a city to finance an indirect income gain for the poor equal in value to the shared revenue entitlement? We offer no response to this question. Indeed it does seem possible that high income citizens may be more attracted by an improvement in city-financed amenities than by a reduction in tax rates.

III. EVALUATION OF GENERAL REVENUE SHARING

Certain conclusions can be drawn from our analysis. The regression results reported in Tables 1 and 2 are evidence that the allocation procedure of the revenue sharing program does not adequately allow for such important factors as a large poverty population, the impact of nonresidents, or tax exporting. Consequently many jurisdictions

[4] These estimates are derived as follows: The local property tax liability borne by the St. Louis poor in 1970 was $2,026,000 [see previous footnote]. Thus $2,026,000 divided by the effective property tax rate on the St. Louis poor, 1.78 percent [see previous footnote], equals $113,800,000, which is 6.5 percent of the St. Louis property tax base in 1970 [see previous footnote].

Similarly $3,774,000 divided by 1.78 percent equals $212,000,000 or 12.1 percent of the St. Louis property tax base in 1970.

[5] It should be noted, however, that tax revenues from sources other than the property tax might well be increased by retaining high income residents in the city. Since local sales and payroll tax collections (the other two major St. Louis taxes) would also increase due to retention of higher income residents, an increase in the property tax base constitutes only one component of the potential indirect gain to the poor in the city from retaining higher income residents.

with scant title to intergovernmental aid, if that aid is to be based on the principal categories of externality, do receive entitlements. Consequently assistance is necessarily reduced for those communities that do have reasonable claim to such assistance. We have also seen that the revenue sharing program does not appear to be target efficient as a redistributive program. It is true that additional goals to those considered here have been proposed for the program. Thus a truly overall evaluation of revenue sharing would also have to consider how the program fares when tested as well against criteria that derive from these other objectives.

IV. AN "URBAN" REVENUE SHARING PROGRAM

In conclusion, an illustrative "urban" revenue sharing program with an annual cost of $2 billion will be outlined. This particular proposal is suggested as one way in which federal shared revenue can be targeted for those communities with large dependent populations. Estimates are shown in Table 3, Column 4, of the entitlements for selected cities if $2 billion were distributed to the 384 cities with a 1974 population of 50,000 and over in proportion to the city's fraction of the total 1970 poverty population residing in these cities. The 1970 poverty population of these 384 cities was 10,011,158. New York City's poverty population in that year was 1,176,333, or 11.7 percent of the total. Thus, for example, New York would receive 11.7 percent of the shared revenue to be distributed, or $235,109,318 as shown in Table 3, Column 4. The amounts received under such a program by the selected cities can be compared with 1) the entitlements they received in 1976 under the existing program (Columns 1 and 2) and 2) the entitlements they would receive if the existing program were simply to be expanded by $2 billion without changing the allocation procedures (Column 3).

Several arguments can be adduced in favor of some such plan as this. 1) The $2 billion additional funds would be targeted to 384 jurisdictions whose population includes nearly 20 percent of the nation's poor and whose eroding fiscal capacity threatens the nation's financial structure. 2) Such a formula is simply understood and can be rationalized in terms of a national policy to channel aid to jurisdictions in proportion to their numbers of dependent citizens. 3) Since such an urban program is designed as an add-on to the present program it would not disturb the allocation of funds to the 38,000 jurisdictions currently receiving aid and so it should be more politically

acceptable than would a complete revision of the shared revenue procedures. 4) However, it must be recognized that the urban shared revenue program as outlined here does not provide a remedy for many of the problems inherent in the allocation procedure of the

TABLE 3

(1) PER CAPITA AND (2) TOTAL GENERAL REVENUE SHARING ENTITLEMENTS, 1975-76, AND TOTAL ENTITLEMENTS FROM AN ADDITIONAL $2 BILLION ALLOCATED (3) UNDER CURRENT PROGRAM AND (4) UNDER URBAN PROGRAM, 10 LARGEST AND SOME SELECTED CITIES

Cities	1975-76 Entitlements Per Capita (1)	Total (2)	Additional $2 Billion Current Program (3)	"Urban" Program (4)
New York[1]	$33.53	$264,732,734	$83,370,955	$235,109,318
Chicago	22.44	75,451,176	23,762,406	97,456,747
Los Angeles	14.80	41,698,891	13,132,023	74,858,487
Philadelphia[1]	26.30	51,257,921	16,142,400	59,977,045
Detroit	26.12	39,470,[illegible]3	12,430,377	45,007,712
Houston	14.80	18,249,898	5,747,[illegible]49	34,730,649
Baltimore[1]	29.00	26,265,998	8,271,819	33,309,653
Dallas	16.39	13,836,722	4,357,530	22,777,869
Washington[1]	35.40	26,777,442	8,432,895	25,704,149
Cleveland	20.87	15,671,045	4,935,204	25,968,824
San Antonio	14.37	9,400,671	2,960,506	28,507,934
Boston[1]	33.23	21,300,807	6,708,157	20,756,235
St. Louis[1]	22.20	13,851,019	4,360,695	25,245,897
Phoenix	16.60	9,653,047	3,039,986	13,716,586
Pittsburgh	25.26	13,141,074	4,138,453	16,010,436
Buffalo	17.73	8,204,665	2,583,854	14,059,201
Newark	23.67	9,050,976	2,850,379	17,195,465
Oakland	15.10	5,460,298	1,719,584	11,997,528
Green Bay, Wisconsin	22.18	1,944,194	612,275	1,349,431
Madison, Wisconsin	17.71	3,068,697	966,409	4,085,779
Maple Bluff, Wisconsin	4.75	8,926	2,811	0
Middleton, Wisconsin	5.23	52,867	16,648	0
Milwaukee, Wisconsin	19.15	13,731,555	4,324,410	16,339,499
Monona, Wisconsin	4.75	49,971	15,736	0
Racine, Wisconsin	17.78	1,528,902	481,489	1,693,303
Shorewood Hills, Wisconsin	4.75	9,876	3,110	0
Dayton, Ohio	18.62	4,533,286	1,427,645	6,909,614
Peoria, Illinois	16.10	2,044,665	643,916	2,968,972
Sioux City, Iowa	15.70	1,348,853	424,788	1,871,913

[1] Since this jurisdiction does not have a distinct overlying county government it does not share the "county area's" entitlement with a county government.

current program, notably the inequities arising from jurisdictions' differing abilities to export taxes. Finally, and perhaps most importantly, such a revision does not address what may be the central question posed by general revenue sharing: Why spread federal funds more or less indiscriminately across thousands of jurisdictions?

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